



Border Carbon Adjustments in the EU – Issues and Options

Stakeholder Meeting – Brussels, 5/3/2020

Andrei Marcu, ERCST
Michael Mehling, ERCST
Aaron Cosbey, ERCST

ERCST

Roundtable on
Climate Change and
Sustainable Transition

Project Schedule

Timing	Action
March – April 2020	Preparation of the report (analysis of BCA issues and options as well as alternatives to BCA)
April 2020	Presentation of the draft report in Brussels
April – September 2020	Update of the report (concurrently with feedback from further meetings)
May – June 2020	Stakeholder meetings in 3 EU capitals (discuss report on BCA and its alternatives and gather input)
September 2020	Presentation of the final report in Brussels
September – October 2020	Stakeholder meetings in 3 EU capitals

BCA Definition

- **Border carbon adjustments (BCAs)** seek to alleviate negative effects of uneven climate policies by including imports and/or exempting exports
- They have three main **objectives**:
 - level the playing field in competitive markets
 - prevent leakage of carbon emissions to jurisdictions with weaker policies
 - incentivise trade partners to strengthen their own climate efforts
- They can take different **forms**:
 - a tariff or other fiscal measure applied to imported goods
 - extension of regulatory compliance obligations (e.g. ETS) to imports
 - a tax exemption or regulatory relief for exports

Why Are We Discussing This Now?

- **Asymmetrical climate change policies**
- **Old methods may not work**
- **Increased level of ambition**
 - Paris Agreement → continued asymmetry of climate efforts
 - European Green Deal
 - Carbon neutrality targets
- **How do we deal with competitive pressures and carbon leakage?**
 - Free allocation/compensation of indirect costs
 - Internationalization/linking/Article 6 Paris Agreement
 - Border carbon adjustments
 - Other options (e.g. consumption charges; contracts for difference; product standards)?
 - **Consumption charges:** charge that extends the carbon price to consumers based on the weight and type of material in a final product
 - **Contracts for difference:** financial award for low-carbon investments based on the amount of avoided carbon and a set carbon price

What Do We Know So Far?

- **Political Guidelines of 16 July 2019:**
*‘To complement this work, and to ensure our companies can compete on a level playing field, I will introduce a **Carbon Border Tax** to avoid carbon leakage. This should be **fully compliant** with World Trade Organization rules. It will start with a number of **selected sectors** and be **gradually extended**.’*



What Do We Know So Far?

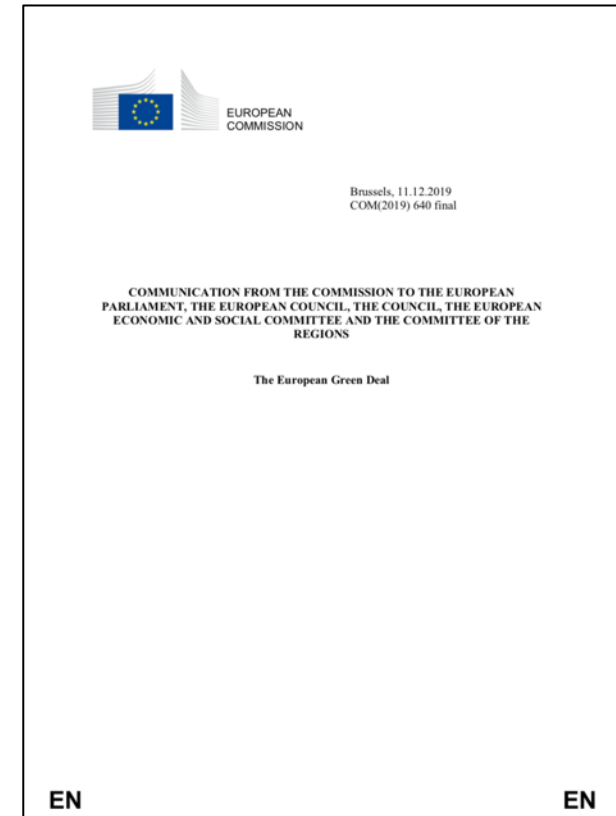
- Mission Letter to **Paolo Gentiloni**, incoming Commissioner for the Economy, 10 September 2019:
*‘You should **lead** on the proposal of a **Carbon Border Tax**, working closely with the Executive Vice-President for the European Green Deal. This is a **key tool** to avoid carbon **leakage** and ensure that EU companies can compete on a level playing field. The Carbon Border Tax should be fully compliant with **WTO rules**.’*
- Also mentioned in the Letters to **Frans Timmermans** (Executive Vice President), **Phil Hogan** (Trade) and **Kadri Simson** (Energy)



What Do We Know So Far?

COM(2019)640 on the European Green Deal of 11 December 2019

*‘Should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a **carbon border adjustment mechanism**, for selected sectors, to reduce the risk of carbon leakage. This would ensure that the price of **imports** reflect more accurately their carbon content. This measure will be designed to **comply with World Trade Organization rules** and other international obligations of the EU. It would be an **alternative** to the measures that address the risk of carbon leakage in the EU’s [ETS].’*



What Do We Know So Far?

COM(2019)640 on the European Green Deal of 11 December 2019

Timeline

Proposal for a revision of the Energy Taxation Directive	June 2021
Proposal for a carbon border adjustment mechanism for selected sectors	2021
New EU Strategy on Adaptation to Climate Change	2020/2021

European Council Meeting Conclusions of 12 December 2019, para. 3:

*'The climate neutrality objective needs to be achieved in a way that preserves the EU's competitiveness, including by developing effective measures to tackle carbon leakage in a **WTO compatible way**. In this context, the European Council **takes note** of the Commission's intention to propose a carbon border adjustment mechanism concerning carbon-intensive sectors. **Facilities in third countries need to adhere to the highest international environmental and safety standards.**'*

What Do We Know So Far?

EU nations pressure Brussels to bring forward carbon border tax proposals

Published 21:05 on February 27, 2020 / Last updated at 21:05 on February 27, 2020 / EMEA, EU ETS /  Carbon Pulse

EU member states want Brussels to propose an EU carbon border adjustment tax earlier than 2021 to help safeguard the bloc's heavy industry, several national ministers said on Thursday.

Council of the European Union meeting (27 February 2020):

- *“The competitiveness of our industry is at stake due to the risk of carbon leakage, so we need to start working on in the second half of this year”, Maria Reyes Maroto, Spanish Minister for Industry, Trade and Tourism*
- *Germany, France and Italy [are also] “impatiently waiting” for Commission’s proposals on border measures*

European Semester 2020 (18 February 2020): *[In] order to help transitioning towards a green economy, fostering the design of budgetary policies conducive to environmental commitments and a review of the Energy Taxation Directive will be proposed, as well as a **WTO-compliant** Carbon Border Adjustment Mechanism, if needed to avoid **carbon leakage**.*

What Do We Know So Far?

Inception Impact Assessment Roadmap (4 March 2020)

Timeline

- Feedback period: 4 March-1 April 2020
- Consultation period: First quarter 2020
- Commission adoption: planned for second quarter 2021

Issues to be studied:

- Type of policy instrument:
 - carbon tax on selected products (imports & domestic)
 - a new carbon customs duty or tax on imports
 - extension of the EU ETS to imports
- Methodological approach to evaluating the carbon content and carbon pricing of imported products
- Sectoral scope



Ref. Ares(2020)1350037 - 04/03/2020

INCEPTION IMPACT ASSESSMENT	
Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to share any relevant information that they may have, including on possible impacts of the different options.	
TITLE OF THE INITIATIVE	Carbon border adjustment mechanism
LEAD DG – RESPONSIBLE UNIT	DG TAXUD Unit C2
LIKELY TYPE OF INITIATIVE	Legislative proposal
INDICATIVE PLANNING	2021
ADDITIONAL INFORMATION	https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en
The Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception Impact Assessment, including its timing, are subject to change.	

A. Context, problem definition and subsidiarity check
Context [max 10 lines]
The European Green Deal adopted by the Commission on 11 December 2019 includes the goal of enshrining the long-term objective of climate neutrality by 2050 in legislation and increasing the EU's climate ambition to reduce greenhouse gases emissions by 50-55% from 1990 levels by 2030. In this context, the European Green Deal emphasized that "should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a carbon border adjustment mechanism, for selected sectors, to reduce the risk of carbon leakage".
The Paris Agreement on climate, as well as strong international diplomacy and leadership, are the EU's main instruments to achieve higher climate ambition globally. By COP26 in November in Glasgow, Paris Agreement Parties need to communicate or update their climate commitments and submit their mid-century strategies, in line with the Paris objectives. The EU will continue to work with partners to raise the global ambition.
Problem the initiative aims to tackle [max 20 lines]
As long as many international partners do not share the same climate ambition as the EU, there is a risk of carbon leakage. Carbon leakage occurs when production is transferred from the EU to other countries with lower ambitions for emission reduction, or when EU products are replaced by more carbon-intensive imports. If this risk materialises, there will be no reduction in global emissions, and this will frustrate the efforts of the EU and its industries to meet the global climate objectives of the Paris Agreement.
In this context, a carbon border adjustment mechanism would ensure that the price of imports reflect more accurately their carbon content. The measure would need to be designed to comply with World Trade Organization rules and other international obligations of the EU. It would be an alternative to the measures that currently address the risk of carbon leakage in the EU's Emissions Trading System ("EU ETS").
Since 2013, the risk of carbon leakage has been effectively addressed for those sectors regulated under the EU ETS that are exposed to the risk of carbon leakage – such as for example steel - by granting free allowances, based on the emissions performance of the best installations under the system (benchmarks). The EU ETS Directive provides for this system to continue at least until 2030. In addition, since the price of carbon is incorporated in electricity prices and passed on to consumers, possibly becoming an indirect source of carbon leakage for some energy-intensive sectors, Member States have the possibility to compensate some electro-intensive industries for the increase in electricity prices resulting from the ETS, provided they comply with EU State aid rules.
Basis for EU intervention (legal basis and subsidiarity check) [max 10 lines]
The legal basis will depend on the design of the measure. Both article 192 (environmental measures including

EU's BCA Plan Becoming Diplomatic 'Hot Topic'

China / Diplomacy

EU's carbon border tax will damage global climate change efforts, China says

- Countries 'need to prevent unilateralism and protectionism from hurting global growth expectations', China's vice-minister for the environment says
- The new tax is aimed at protecting European firms from unfair competition by raising the cost of products from countries that fail to take action on climate change

Reuters
Published: 2:38pm, 27 Nov, 2019



FINANCIAL TIMES

SUSTAINABLE BUSINESS OCTOBER 2, 2019 / 12:19 PM / 4 MONTHS AGO

EU leaders risk trade tension with carbon border tax plan to shield industry

Susanna Twidale, Barbara Lewis

6 MIN READ

LONDON (Reuters) - The new European Union executive risks inflaming international tensions over trade and the environment even before it takes office in November by promising a carbon border tax to shelter its industry from the cost of cutting emissions.

Climate change + Add to myFT

EU risks trade fight over carbon border tax plans

Brussels wants to help businesses compete while pursuing climate change targets



© Bloomberg

Sam Fleming in Brussels and Chris Giles in London OCTOBER 16 2019

Sam Fleming in Brussels and Chris Giles in London OCTOBER 16 2019

Trade disputes + Add to myFT

US threatens retaliation against EU over carbon tax

Wilbur Ross warns environmental plan could be new irritant in trade relations with Europe



Right to left: Wilbur Ross, US secretary of commerce, Ivanka Trump, adviser and daughter of the US president, and Swiss defence minister Viola Amherd, applaud at the last plenary session on the final day of the 50th annual meeting of the World Economic Forum in Davos on Friday. © AP

Gillian Tett and Chris Giles in Davos and James Politi in Washington JANUARY 26 2020

290

The EU's plans for a carbon tax have emerged as a potential new flashpoint in transatlantic trade ties, after the Trump administration warned that it would "react" with possible punitive measures against Brussels.

Wilbur Ross, the US commerce secretary, compared the EU's proposals to recent moves by several European countries to impose a digital services tax, which has angered US officials and caused Washington to threaten tariffs on

which has angered US officials and caused Washington to threaten tariffs on

ERCST BCA Report Concept

- Decompose and analyze the main elements of BCA design and implementation (see below)
- Analysis based on 5 criteria (see below)
- Elaboration and analysis of 2-3 ‘policy packages’ that describe what a BCA could look like in practice

BCA Elements

- **Coverage of trade flows:** imports, exports, or both?
- **Policy mechanism:** tax, customs duty, extensions of EU ETS, or other?
- **Scope**
 - *Geographic scope:* all countries, or narrower scope/exemptions?
 - *Sectoral scope:* basic materials, electricity, compound manufactured goods?
 - *Emissions scope:* direct emissions only, or also indirect emissions?
- **Determination of embedded emissions:** based on avgs. or actual data?
- **Calculation of adjustment:** explicit carbon price differential, other?
- **Use of revenue:** EU budget, environmental investment, climate finance?
- **Institutions and process**
 - *Institutional governance:* designated institution/agency?
 - *Process flow and timeline:* study of feasibility/impacts, consultations, expiration?

Criteria of Analysis

- **Environmental benefit:** Effectiveness in preventing emissions leakage and incentivizing climate action by trade partners
- **Competitiveness benefit:** Ability to level the competitive playing field and shield European industry against competitive disadvantage
- **Legal feasibility:** compatibility with international law, especially WTO law and the international climate regime (*see separate slide*)
- **Technical and administrative feasibility:** technical viability; complexity and cost of implementation (e.g. resource or data needs)
- **Political feasibility** with domestic constituencies and Member States, as well as potential to **disrupt diplomatic and trade relations**

Relevant Provisions of the GATT

Non-discrimination principles in WTO law:

- **Most-Favoured-Nation:** equal treatment of trading partners (Art. I GATT)
- **National Treatment:** equal treatment of domestic & foreign products (Art. III GATT)

Exemptions are possible under specific circumstances:

- Art. XX (b) GATT: measures '**necessary**' to protect human, animal or plant life or health
- Art. XX (g) GATT: measures '**relating to**' the conservation of exhaustible nat. resources
- Chapeau: "not ... a means of **arbitrary** or unjustifiable discrimination between countries where the same conditions prevail, or a **disguised restriction** on international trade"

Some consequences for BCAs:

- BCAs should **avoid differentiating** between trade partners & **account** for climate efforts
- BCAs should ensure fairness & **due process** and be preceded by serious **negotiations**
- BCAs should demonstrate a sufficient **environmental nexus**
- BCAs to exempt **exports** and BCAs **coupled with free allocation** are legally problematic

Criteria of Analysis

- **Environmental benefit:** Effectiveness in preventing emissions leakage and incentivizing climate action by trade partners
- **Competitiveness benefit:** Ability to level the competitive playing field and shield European industry against competitive disadvantage
- **Legal feasibility:** compatibility with international law, especially WTO law and the international climate regime (*see separate slide*)
- **Technical and administrative feasibility:** technical viability; complexity and cost of implementation (e.g. resource or data needs)
- **Political feasibility** with domestic constituencies and Member States, as well as potential to **disrupt diplomatic and trade relations**

Coverage of Trade Flows

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Imports	Relatively greatest benefit due to maximum emissions coverage	Levels the playing field in the domestic market	Strongest case under Article XX GATT	More complex to implement due to data gaps and limited jurisdiction	Controversial as a unilateral, extraterritorial measure
Exports	Relatively lowest benefit due to reduced emissions coverage and pot. incentive for carbon-intensive exports	Levels the playing field in foreign markets	Risks being considered a forbidden subsidy under SCM Agreement; weak Art. XX GATT case	Least complex to implement because purely domestic and data readily available	Least controversial because purely territorial measure with no obligations for foreign producers
Imports & Exports	Environmental benefit between the two cases above	Levels the playing field in both domestic & foreign markets	Same as above, plus even greater risk under SCM Agreement	More complex to implement for imports due to data gaps and limited jurisdiction	Most controversial because of extraterritoriality and perceived protectionism

Policy Mechanism

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Carbon Tax	Neutral (depends on level of carbon price)	Neutral	Requires unanimous vote in the Council	Relatively easier to implement due to absence of trading component	Neutral
Customs Duty	Neutral (depends on level of carbon price)	Neutral	Can be adopted with qualified majority vote	May be easiest to implement due to ability to build on existing customs infrastructure	Neutral
Extension of the EU ETS	Neutral (depends on level of carbon price, and to lesser extent on price volatility/predictability in the market)	Neutral	Can be adopted with qualified majority vote, but potentially riskier under trade law (esp. re. exports)	Relatively more difficult to implement due to integration in/link to EU ETS market	Neutral

Geographic Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
All Countries	Greatest coverage of emissions	Levels the playing field vis-à-vis all countries	Least risky under Article I GATT	Relatively more complex due to inclusion of largest number of countries	Somewhat controversial because perceived as unfair & protectionist
Exemption of Least-Developed Countries	Modest loss of emissions coverage; could change over time	Levels the playing field in foreign markets	Risks violating Art. I GATT, but aligns with established principles and practice	Relatively the least complex due to flat exclusion of large number of countries	Least controversial because perceived to be fairer and less protectionist
Exemption on Environmental Grounds (e.g. Carbon Price, Party to Paris Agreement)	Loss of emissions coverage may be offset by incentive to strengthen climate policies	Levels the playing field vis-à-vis countries with weaker constraints (may only be partial)	Risks violation of Art. I GATT, will likely need recourse to Art. XX GATT	Relatively most complex due to large number of countries and need to determine/compare environmental effort	Most controversial because of differentiation & rating other countries' behavior

Sectoral Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Basic Materials only (EITEs)	Relatively the least beneficial because of reduced emissions coverage	Levels the playing field for a limited number of products	Art. XX GATT: less complex, but also less environmentally beneficial	Least complex because of limited scope and relative availability of data	Least controversial due to limited scope (esp. with narrowly traded goods)
Basic Materials (EITEs) & Electricity	Relatively greater environmental benefit due to expanded emissions coverage	Levels the playing field for a larger number of products	Art. XX GATT: more complex, but also greater environmental benefit	Relatively more complex due to expanded scope and additional data need	Relatively more controversial due to expanded scope (but: electricity narrowly traded)
Basic Materials, Electricity & More Complex Products	Relatively greatest benefit due to maximum emissions coverage	Levels the playing field for the greatest number of products, including domestic manufacturers that use covered inputs	Art. XX GATT: most complex, but also greatest environmental benefit; still: necessity unclear	Most complex to implement due to significant data gaps and technical challenges	Relatively most controversial due to expansive scope, data & technical challenges and trade intensity of goods

Emissions Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Direct (Scope 1) Emissions	Relatively lowest environmental benefit due to lower emissions coverage	Levels the playing field with regard to cost of direct emissions only	Art. XX GATT: least complex, but also least env'tally. beneficial	Relatively least complex due to limited data needs	Relatively least controversial due to most limited scope
Indirect (Scope 2) Emissions from Energy	Relatively greater environmental benefit due to expanded emissions coverage	Levels the playing field with regard to cost of direct emissions & indirect energy emissions	Art. XX GATT: more complex, but also greater envt'l benefit	Relatively more complex due to additional data needs	Relatively more controversial due to expanded scope
Other Indirect (Scope 3) Emissions	Relatively greatest environmental benefit due to highest emissions coverage	Levels the playing field with regard to cost of all direct & indirect emissions	Art. XX GATT: most complex, but also greatest envt'l benefit; still: necessity unclear	Relatively most complex due to greatest data needs	Relatively most controversial due to most expansive scope

Determination of Embedded Emissions (1/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Calculation at product level (each shipment)	Most accurate measurement, so highest environmental benefit	Levels the playing field facility by facility - strong	Strong case under Art. XX: non-arbitrary	Highly complex data needs, esp. if scope 3 covered	Relatively controversial - burdensome
Benchmark: best practice domestic/global	Relatively weak benchmark, allows most leakage	Assumption benefits foreign producers ==> uneven playing field	Strong case under Art. XX: less discriminatory	Least complex: data mostly available	Relatively less controversial - low burden, beneficial assumptions
Benchmark: worst practice domestic/global	Relatively strong benchmark, allows least leakage	Assumption penalizes foreign producers ==> benefits domestic	Weaker case under Art. XX: punitive	Least complex: data mostly available	Highly controversial - punitive assumptions

Determination of Embedded Emissions (2/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Benchmark: average carbon intensity of EU producers	Somewhat weak benchmark, allows more leakage	Assumption benefits foreign producers that perform worse than EU average ==> uneven playing field	Strong case under Art. XX: less discriminatory	Least complex: data mostly available	Relatively less controversial - low burden, somewhat beneficial assumptions
Benchmark: best foreign practice	Relatively weak benchmark, allows more leakage	Assumption benefits foreign producers ==> uneven playing field	Strong case under Art. XX: less discriminatory	Relatively complex due to limited data availability	Relatively less controversial - low burden, beneficial assumptions
Benchmark: worst foreign practice	Relatively strong benchmark, allows least leakage	Assumption penalizes foreign producers ==> benefits domestic	Weaker case under Art. XX: punitive	Relatively complex due to limited data availability	Most controversial - punitiv assumptions
Hybrid benchmark: scope 2 actual foreign	Accurate measurement, may allow little leakage	Depends on the assumptions for non-scope 2	Balance: strong Art. XX case on scope 2; non-scope 2 depends on assumptions	Relatively complex due to additional data needs	Relatively controversial - depends on non-scope 2 assumptions

Calculation of Adjustment

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
No consideration of foreign policies	No leakage, but also no incentive for good foreign environmental practice	Offers more than full protection	Vulnerable under Art. XX: arbitrary	Most feasible option	Relatively controversial - seen as unfair
Consideration of price-based policies	No leakage, but also limited incentive for good foreign environmental practice	Offers slightly more than full protection	Strong case under Art. XX: less discriminatory	Feasible, but more complex	Relatively less controversial
Consideration of price-based and regulatory policies	No leakage; full incentive for good foreign environmental practice	Offers full protection	Strongest case under Art. XX	Very complex: hard to equate regulatory policies to prices	Potentially least controversial, depending on details of adjustment methodology

Use of Revenue (1/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Refund to covered domestic firms	No leakage impacts; may enable environmental improvements	Offers more than full protection; domestic subsidy	Likely illegal under SCM Agreement; weakens case under Art. XX	Complex but feasible	Relatively controversial - seen as unfair
Refund to covered foreign firms	No leakage impacts; may enable foreign environmental improvements	Offers more than full protection; foreign subsidy	Strong case under Art. XX	Very complex, but feasible	Controversial domestically
Put into general revenue	No leakage impacts; no environmental impacts	Neutral impacts	Neutral legal implications	Straightforward, feasible option	Not particularly controversial

Use of Revenue (2/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Domestic fund for climate innovation	no leakage impacts; likely to create environmental improvement	May increase domestic competitiveness	May weaken case under Art. XX	Complex but feasible	Not particularly controversial
Domestic fund for competitiveness	No leakage impacts; may enable environmental improvement	Likely to increase domestic competitiveness	Likely weakens case under Art. XX	Complex, but feasible	Would be seen as controversial by trading partners
International fund for climate	No leakage impacts; likely to have positive climate impacts	Neutral impacts	Strengthens case under Art. XX	Straightforward, feasible option	Would be seen positively by international partners